

Message Text

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ACTION TRSE-00

INFO OCT-01 EA-10 ISO-00 CIAE-00 PM-05 H-01 INR-10

L-03 NSAE-00 NSC-05 PA-01 SP-02 SS-15 USIA-06

AID-05 COME-00 EB-08 FRB-03 XMB-02 OPIC-03 LAB-04

SIL-01 OMB-01 STR-07 CEA-01 NEA-10 IO-13 /117 W

-----098885 030504Z /11

R 030410Z MAR 78

FM AMEMBASSY MANILA

TO SECSTATE WASHDC 2448

INFO AMEMBASSY SEOUL

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USADB

FOR NAC AGENCIES

E.O. 11652: N/A

TAGS: EAID, EFIN, KS, SHUM

SUBJECT: PROPOSED ADB FIFTH KOREA DEVELOPMENT BANK PROJECT
(KOREA)

REF: MANILA 2239

SUMMARY: ADB MANAGEMENT IS PROPOSING \$50 MILLION LOAN FROM ORDINARY CAPITAL RESOURCES FOR THE KOREA DEVELOPMENT BANK (KDB). THE PROPOSED LOAN IS THE FIFTH IN A SERIES OF ADB LOANS FOR THE KDB AIMED AT ASSISTING MEDIUM AND LARGE SCALE INDUSTRIES; PARTICULARLY INDUSTRIES OR INDUSTRIAL SUBSECTOR DEEMED HIGH PRIORITY BY GOVERNMENT. THE KDB IS A WELL RUN ORGANIZATION THAT IS FINANCIALLY SOUND. USADB HAS NO TECHNICAL PROBLEMS WITH LOAN, THOUGH, GIVEN HUMAN RIGHTS CONSIDERATIONS NAC GUIDANCE IS REQUESTED. END SUMMARY.

1. ADB DOCUMENT R15-78 WITH ATTACHMENTS POUCHED ADDRESSEES
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FEBRUARY 24. BOARD CONSIDERATION SCHEDULED MARCH 16.

2. ADB MANAGEMENT PROPOSING \$50 MILLION ORDINARY CAPITAL LAON TO KOREA DEVELOPMENT BANK. PROCEEDS OF LOAN WILL BE USED BY KDB TO FINANCE FOREX COSTS OF ITS BORROWERS. IT IS EXPECTED THAT KDB BORROWERS WILL BE FROM GOVERNMENT DESIGNATED INDUSTRIES OR INDUSTRIAL SUBSECTORS; NAMELY, TEXTILES (10

PERCENT), BASIC METALS (15 PERCENT), MACHINERY (30 PERCENT), MANUFACTURING (5 PERCENT), TRANSPORTATION (20 PERCENT) AND MISCELLANEOUS (5 PERCENT). BORROWER WILL BE KOREA DEVELOPMENT BANK. PROPOSED TERMS ARE 15 YEARS AMORTIZATION PERIOD INCLUDING 3 YEARS GRACE AT 7.65 PERCENT INTEREST. PROPOSED LOAN WILL BE GUARANTEED BY REPUBLIC OF KOREA.

3. KDB IS A GOVERNMENT-OWNED FINANCIAL INSTITUTION WHICH WAS ESTABLISHED IN 1954 FOR THE PRIMARY PURPOSE OF PROVIDING AND ADMINISTERING FUNDS FOR THE DEVELOPMENT OF THE INDUSTRIAL SECTOR OF THE ECONOMY. THE GOVERNMENT CONTROLS THE OPERATIONS OF KDB UNDER THE SUPERVISION OF THE MINISTRY OF FINANCE. KDB IS USED AS A CONDUIT FOR GOVERNMENT FUNDS TO MEET THE CREDIT NEEDS OF THE SUBSECTORS AND PRIORITY INDUSTRIES AS DETERMINED BY THE GOVERNMENT. KDB'S TOTAL ASSISTANCE (INCLUDING EQUITY) TO GOVERNMENT-INVESTED AND DESIGNATED ENTERPRISES ACCOUNTS FOR A MAJOR PART OF ITS OVERALL OPERATIONS AND PORTFOLIO.

4. IN FINANCING GOVERNMENT-INVESTED AND DESIGNATED ENTERPRISES, NEITHER THE TYPE OF PROJECT NOR THE TERMS AND CONDITIONS OF THE ASSISTANCE PROVIDED CAN BE DECIDED BY KDB INDEPENDENTLY. THIS HAS LED TO A HEAVY CONCENTRATION IN KDB'S PORTFOLIO OF ASSISTANCE TO A RELATIVELY FEW NUMBER OF LARGE PROJECTS IN THE PRIORITY SECTORS, SUCH AS CHEMICALS AND METAL PRODUCTS, PRODUCTION AND DISTRIBUTION OF ELECTRIC LIMITED OFFICIAL USE

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POWER, ETC. THIS HAS ALSO LED TO AN EXPOSURE TO INDIVIDUAL ENTERPRISES IN EXCESS OF NORMS WHICH WOULD STRICTLY BE CONSIDERED FINANCIALLY PRUDENT. KDB, THEREFORE, HAS IN ITS PORTFOLIO NUMBER OF "EXCEPTIONS" FROM THE GUIDELINES OF FINANCIAL PRUDENCE SET OUT IN ITS POLICY STATEMENTS; SUCH "EXCEPTIONS" FORM ABOUT 74 PERCENT OF ITS PORTFOLIO, INCLUDING A NUMBER OF LOANS AND GUARANTEES FOR WHICH ADEQUATE COLLATERAL HAS NOT BEEN OBTAINED. HOWEVER, THE GOVERNMENT PROTECTS KDB FOR RISKS INHERENT IN THIS TYPE OF OPERATIONS. FIRST, THROUGH THE GUARANTEE RELEASE ARRANGEMENT, KDB IS PROTECTED AGAINST EROSION OF ITS LIQUIDITY AND, TO SOME EXTENT, AGAINST LOSSES DUE TO POSSIBLE DEFAULTS BY GOVERNMENT-INVESTED AND DESIGNATED ENTERPRISES TO WHICH KDB HAS EXTENDED GUARANTEE. SECOND, THE GOVERNMENT HAS GIVEN A GUARANTEE FOR KDB LOANS TO SELECTED GOVERNMENT-INVESTED ENTERPRISES. THIRD, THE BORROWINGS FROM THE GOVERNMENT WHICH HAVE BEEN OBTAINED FOR RELENDING TO DESIGNATED ENTERPRISES (E.G. THE KOREA ELECTRIC COMPANY) REPAYMENT WOULD BE CONDITIONAL UPON KDB'S RECOVERY OF THE LOAN. FOURTH, THE GOVERNMENT HAS UNDERTAKEN THAT IN CASE EQUITY SHARES ARE TRANSFERRED FROM GOVERNMENT HOLDINGS TO KDB, THIS WILL BE DONE AT A PRICE NOT EXCEEDING THEIR APPRAISED VALUE.

5. FOR ITS OVERALL OPERATIONS, KDB ENJOYS FULL GOVERNMENT SUPPORT INCLUDING BUDGETARY ALLOCATIONS FOR INCREASE IN KDB'S PAID-UP CAPITAL, EXEMPTIONS FROM GOVERNMENT TAXES AND LEVIES (EXCEPT THE SMALL DEFENSE TAX), UNDERTAKEN BY THE GOVERNMENT TO MEET ALL LOSSES IN EXCESS OF KDB'S ACCUMULATED RESERVES AND A SUBSIDY TO KDB TO COVER BORROWING AND LENDING ACTIVITIES.

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FOR NAC AGENCIES

6. KDB ARREARS ARE COMPARATIVELY LOW AND FEW LOANS HAVE BEEN RESCHEDULED. HOWEVER, IN CASES OF GOVERNMENT-INVESTED AND DESIGNATED ENTERPRISES, WHENEVER A DEFAULT OCCURS, THE LOAN TENDS TO BE RESCHEDULED SO THAT ARREARS IN THE TRUE SENSE ARE DIFFICULT TO ASSESS. KDB'S PROFITABILITY (NET PROFIT TO AVERAGE EQUITY) INCREASED FROM 2.9 PERCENT IN 1974 TO 7.8 PERCENT IN 1976, MAINLY BECAUSE OF THE WIDER INTEREST MARGIN WHICH STILL REMAINS RELATIVELY NARROW. THE IMPROVEMENT IN PROFITABILITY IS EXPECTED TO CONTINUE AND THE EARNINGS SPREAD SHOULD REMAIN FAIRLY STABLE, WITH A CONTINUED BUT SLIGHT INCREASE TO 00 PERCENT IN 1980. THIS WILL RESULT IN AN INCREASED RETURN ON EQUITY FROM 7.8 PERCENT IN 1976 TO 10 PERCENT IN 1980.

7. THE AVERAGE SIZE OF SUB-LOANS INCREASED FROM \$0.3 MILLION UNDER THE FIRST CREDIT LINE TO \$1.0 MILLION FROM THE FOURTH CREDIT LINE. THE FREE LIMIT INCREASED FROM \$0.2

MILLION FOR THE FIRST LOAN TO \$0.75 MILLION FROM THE FOURTH
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LOAN AND A FREE LIMIT OF \$1 MILLION IS REQUESTED FOR THE
PROPOSED LOAN. IN ORDER TO ENSURE THAT THE BANK FUNDS ARE
CHANNELED TO A REASONABLE NUMBER OF SUB-PROJECTS, THE SIZE
OF INDIVIDUAL SUB-LOANS IS RECOMMENDED TO BE MAINTAINED AT
\$4 MILLION.

8. KDB'S PROCUREMENT POLICIES AND PROCEDURES ARE CONSIDERED
SUITABLE, BY THE BANK FOR ITS OPERATIONS. INTERNATIONAL
COMPETITIVE BIDDING (ICB) IS GENERALLY EMPLOYED IN CASE OF
FOREIGN LOANS. THIS IS IN LINE WITH THE GOVERNMENT'S
REGULATION AND UNLESS ICB PROCEDURES ARE CLEARLY INAPPRO-
PRIATE, KEEPING IN VIEW THE NATURE OF THE PROJECT,
EXCEPTIONS ARE NOT ALLOWED. IN RESPECT OF THE BANK'S LOAN,
KDB WILL ENSURE THAT PROCUREMENT PROCEDURES ADOPTED BY THE
SUB-BORROWERS ARE APPROPRIATE AND THAT ALL GOODS AND SERVICES
ARE PURCHASED AT REASONABLE PRICES. THE BANK WILL NOT INSIST
ON ICB (AS PER ESTABLISHED PRACTICE) BUT RESERVES THE RIGHT
TO REQUIRE ICB PARTICULARLY FOR LARGE SUB-LOANS.

9. IN LINE WITH KDB'S RAPIDLY GROWING INTERNATIONAL BUSINESS
OPERATIONS, AND THE INCREASING ROLE OF FOREIGN TRADE AND
INVESTMENTS FOR ENTERPRISES FINANCED BY IT, KDB HAS EXPANDED
THE NUMBER OF ITS OVERSEAS REPRESENTATIVE OFFICES FROM
FOUR (TOKYO, NEW YORK, LONDON, KUWAIT) TO SIX (WITH THE
ADDITION OF HONG KONG AND SINGAPORE) SINCE THE LAST PROJECT.
THE OVERSEAS OFFICES PLAY A KEY ROLE IN MOBILIZING FOREIGN
CAPITAL RESOURCES FOR KDB AND ITS CLIENT ENTERPRISES AND
ALSO SERVE AS INVESTMENT PROMOTION OFFICES FOR THE GOVERN-
MENT. KDB HAS RECENTLY ESTABLISHED A CAPITAL INVESTMENT
COMPANY, KOREAN ASSOCIATED SECURITIES INCORPORATED (KASI) IN
NEW YORK FOR THE PRIMARY PURPOSE OF RAISING LONG-TERM FUNDS
FROM THE NEW YORK CAPITAL MARKET. KASI COMMENCED OPERATIONS
IN OCTOBER 1977.

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10. PRIVATE INDUSTRIAL ENTERPRISES ARE EXPECTED TO BE FINANCED
THROUGH THE PROPOSED LOAN. THE KDB IS BEING ENCOURAGED TO
USE BANK FUNDS FOR THE FINANCING OF SMALL AND MEDIUM SIZE
ENTERPRISES ON A SELECTIVE BASIS. PREFERENCE WILL BE GIVEN
TO ENTERPRISES WHICH: (I) PRODUCE "WAGE GOODS" (I.E FOR
MASS CONSUMPTION); (II) CONTRIBUTE TO THE TRANSFER OF TECH-
NOLOGY; AND (III) CONTRIBUTE TO THE DEEPENING OF THE

INDUSTRIAL STRUCTURE IN KOREA. IT IS EXPECTED THAT AS A RESULT OF THE PROPOSED PROJECT, (I) AN ADDITIONAL 6,000 PEOPLE WILL BE EMPLOYED (AT AN AVERAGE COST OF \$12,000 TO \$13,000 PER JOB); (II) \$25 MILLION IN INCREMENTAL SALARIES WILL BE GENERATED; AND (III) VALUE ADDED WILL BE INCREASED BY ABOUT \$90 MILLION.

11. USADB COMMENT: AS THE ADB DOCUMENT STATES, ALL BANKS IN KOREA OPERATE WITHIN A TIGHTLY CONTROLLED ENVIRONMENT WHERE THE SCOPE FOR INDEPENDENT DECISION-MAKING WITHIN THE INSTITUTION WITH REGARD TO CREDIT CREATION, LIQUIDITY AND PROFITABILITY IS RELATIVELY LIMITED. IN THE CASE OF GOVERNMENT-OWNED INSTITUTIONS LIKE THE KDB THE EXTENT OF GOVERNMENT CONTROL IS MORE PERVASIVE WHERE ANNUAL OPERATING PROGRAMS HAVE TO BE APPROVED BY THE GOVERNMENT AND THE CHOICE OF LOAN AND INVESTMENT PORTFOLIO IS HEAVILY INFLUENCED BY THE NEED TO FINANCE GOVERNMENT-DESIGNATED ENTERPRISES. WITHIN THIS CONTEXT THE KDB HAS BEEN AN EFFECTIVE INSTRUMENT IN PROMOTING ECONOMIC GROWTH IN KOREA. THE ORGANIZATION IS WELL RUN AND, GIVEN THE LEVEL OF GOVERNMENT SUPPORT IT RECEIVES, IS FINANCIALLY VIABLE. THE LOAN APPEARS TO BE ECONOMICALLY AND TECHNICALLY SOUND, THOUGH, GIVEN HUMAN RIGHTS CONSIDERATION USADB REQUESTS NAC GUIDANCE.

12. REQUEST AMEMBASSY SEOUL'S COMMENTS FOR NAC AGENCIES
INFO USADB MANILA PURSUANT TO STATE 119795 DATED 3 JULY 1972.
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Message Attributes

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